

# **CAPITAL PROJECT FUND POTENTIAL SHORTFALL/IMPACTS**

A Report Prepared for the

## **Legislative Finance Committee**

By

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## PURPOSE

The legislature appropriates revenue derived from the capitol land grant trust lands to fund building and maintenance projects in the capitol complex. In fiscal 2003, revenue was less than anticipated, and anticipated expenditures in the 2005 biennium exceed anticipated revenue. As a result, there is not enough money to fund all the projects and the executive is considering the postponement of certain projects that the legislature expected to be completed in the 2005 biennium. This report discusses the source of revenue; diversions of the revenue; various projects funded from the revenue; specifics of capitol land grant projects, funding and appropriations; causes of the funding problem; executive actions/options; legislative considerations; and related legal issues uncovered by staff research.

## INTRODUCTION

Capitol land grant revenue, derived from 182,000 surface acres of trust lands granted to Montana in the Enabling Act (the acreage has since expanded to 186,956) and 230,007 acres of mineral rights, is designated in the Enabling Act (Section 12) as a funding source for building projects in the state capitol complex. Specifically, Section 12 authorizes the revenue to be used for:

“public buildings at the capital of said states for legislative, executive, and judicial purposes, including construction, reconstruction, repair, renovation, furnishings, equipment, and any other permanent improvement of such buildings and the acquisition of necessary land for such buildings, and the payment of principal and interest on bonds issued for any of the above purposes.”

As such, this revenue has long been used as a source of funding for long-range building projects (either directly or through the servicing of debt financing such projects) and, more recently, for general maintenance of state buildings in the capitol complex.

## CAPITOL LAND GRANT REVENUE

Capitol land grant trust lands produce revenue from: 1) the sale of timber; 2) grazing, agricultural, and other rentals; 3) mineral royalties; and 4) oil and gas leases, bonuses and penalties. In fiscal 2003, this revenue totaled \$1,586,802 (Table 1). The largest single revenue source is timber sales, which comprised 78 percent of all revenue in fiscal 2003.

Table 1		
Capitol Land Grant Revenue		
Fiscal 2003		
Revenue Type	Amount	% of Total
Total timber sales	\$1,238,901	78.08%
Grazing rentals	170,050	10.72%
Misc. rentals	80,082	5.05%
Agricultural rentals	43,195	2.72%
Oil & gas leases	18,497	1.17%
Gas royalties	13,330	0.84%
Misc. Perm. Income	13,095	0.83%
Oil royalties	4,461	0.28%
Oil & gas penalties	4,170	0.26%
Oil & gas bonus	1,020	0.06%
Total Revenue	\$1,586,802	100.00%

## DIVERSIONS

Not all revenue produced from capitol land grant trust land is available for the legislature to appropriate for capital projects and other allowable uses. The Department of Natural Resources and Conservation (DNRC) statutorily diverts a portion of this revenue for administrative purposes before the remainder is transferred to the capital project fund and appropriated by the legislature. In fiscal 2003, \$881,810, or 56 percent of all revenue was diverted for administration purposes (Table 2). The remaining \$588,552 was transferred to the capital projects fund and became available to fund projects appropriated by the legislature. Statute allows the following four diversions:

1. 77-1-108 & 109, MCA – Certain revenue from all trust lands are diverted to the trust land administration account and is used to pay costs of administering state trust lands based on the amount appropriated by the legislature. The maximum amount of capitol land grant revenue that can be diverted to this account is 10 percent of the previous fiscal year's revenue deposited to the capitol land grant trust.
2. 77-1-607, MCA – Up to three percent (the Land Board has set the current rate at three percent) of income from trust lands is deposited in the resource development account and is used to develop and improve state lands. The three percent does not apply to investment earnings and timber sale revenue deducted under 77-1-613, MCA (see below).
3. 77-1-613, MCA – Timber sale revenue is deposited in the state timber sale account based on the amount appropriated by the legislature, and is used by DNRC for timber sale preparation and documentation. Although statute allows diversion of timber sale revenue from all state lands, only timber sale revenue from the capitol land grant and the common school trusts is currently used to fund the timber sales program.
4. 77-2-362, MCA – Revenue from the sale of capitol land grant trust lands (and other trust lands) are held in a land bank fund to purchase additional trust lands (enacted in House Bill 223 by the 2003 legislature). Up to ten percent of the proceeds in the state land bank fund may be used by the DNRC to fund the transactional costs of buying, selling, appraising, or marketing the real property.

Table 2  
Divisions of Capitol Land Grant Revenue  
Fiscal 2003

<u>Item</u>	<u>Amount</u>
Timber revenue for timber sale preparation based on legislative appropriations	\$567,082
Maximum of 10% of previous year's revenue for trust land administration	305,417
Maximum of 3% of income excluding timber for resource development	9,311
Maximum of 10% of land bank sales for transactional costs	0
Total	\$881,810

An opinion clarifying the legality of these diversions is being sought from the Legislative Services Division.

## CAPITOL LAND GRANT PROJECTS

Capitol land grant revenue has been an important funding source for capital projects for many years. Among the more recent projects completed with appropriations from this fund are the construction of the Justice Building and the latest remodeling work of the Capitol Building. In past biennia, the Department of Administration, Architecture and Engineering Division, through the long-range building program, completed two or three projects using these funds.

The capitol land grant fund is obligated for the debt service on two bond issues. Long-range spending has not typically been prioritized, yet the debt service obligations are always the first priority. The bonds were issued for the construction of the Justice Building and the remodeling of the Capitol Building. Debt service payments are expected to be \$168,751 in fiscal 2004 and \$510,726 in fiscal 2005.

## APPROPRIATIONS

Table 3  
Capitol Projects Fund  
Appropriated Projects

Project	Legislative Session	Agency	2005 Biennium Appropriations
Capitol complex maintenance	2003	DofA	\$1,000,000
Repair capitol front stairs *	2003	LRBP	400,000
Land acquisition capitol complex*	2003	LRBP	600,000
Capitol complex grounds	2001	FWP	150,000
Capitol complex land acquisition*	2001	LRBP	400,000
Debt service for capitol renovation**	1999	DofA	508,328
Capitol irrigation & landscape	1999	FWP	846
Capitol restoration	1995	LRBP	1,505
Capitol complex property acquisition	1991	LRBP	20,000
Debt service for DOJ building**	1979	DofA	<u>171,149</u>
Total appropriations			\$3,251,828

\* Elimination or postponement of these projects are being considered by the executive and are discussed later in the report.

\*\* Debt service is statutorily appropriated

DofA = Department of Administration

LRBP = Long-range Building Program

FWP = Department of Fish, Wildlife and Parks

Table 3 shows the valid appropriations from the capitol projects fund for the 2005 biennium listed by the session year in which the legislature made the appropriations. Currently, there are eight long-range building project appropriations and two debt service appropriations from the capital projects fund, totaling \$3.3 million for the biennium. As directed by 17-7-212, MCA, appropriations for capital projects continue until the projects are completed. Because of this, there are five non-debt service appropriations that originated more than one biennium in the past, with one originating in the 1991 legislative session.

The type of projects for which the revenue is used has changed. In the past, the revenue was an important funding source for many long-range building projects. However, the 1997 legislature appropriated \$500,000 of the revenue in House Bill 2 for general building maintenance within the capitol complex. The 2001 legislature appropriated \$1,866,110 for the same purpose and the 2003 legislature appropriated another \$1,000,000. Appropriations have also been made for improvements on capitol complex grounds. The 1999 and 2001 legislatures appropriated \$225,000 and \$150,000 respectively for this purpose. These appropriations prevented increases in rent (including amounts paid for ground maintenance) that agencies in the capitol complex pay for general maintenance and reduced general fund appropriations, but they also reduced the revenue available for funding the more traditional long-range projects. Since building maintenance and land improvements are not mentioned in the Enabling Act, an opinion on the legality of using capitol land grant revenue for these purposes is being sought from the Legislative Services Division.

Other than the appropriations for debt service (statutorily appropriated) and the \$1,000,000 for general building maintenance in the capitol complex (appropriated in House Bill 2), the other projects are appropriated in House Bill 5. The legislature has placed conditions on the following appropriations of capitol land grant revenue in House Bill 5:

1. The 2003 legislature stipulated that if \$130,000 in appropriated federal community transportation enhancement revenue was short, the \$400,000 of capital and grant revenue appropriated to repair the front stairs of the capital was to increase by the amount of the shortfall. The legislature also stated that the \$600,000 appropriation to acquire capitol complex land is the last priority for

capitol land grant funds in the 2005 biennium and is dependent on the availability of revenue. Both projects may be phased in as capitol land grant revenue becomes available (an opinion is being sought from the Legislative Services Division on whether the \$400,000 appropriation to repair the capitol stairs is included in this condition).

2. The 2001 legislature stipulated that the \$400,000 appropriation of capitol land grant revenue to acquire capitol complex land and the \$150,000 to the Department of Fish, Wildlife and Parks for capitol complex ground maintenance were the last priorities for the 2003 biennium and were dependent upon the availability of revenue. The legislature further stated that the Department of Administration, Architecture and Engineering Division are to set priorities for revenue available for these two projects. None of these two appropriations was used in the 2003 biennium and both are authorized to continue in the 2005 biennium.

## FUND BALANCE

The fiscal 2003 ending fund balance in the capital project fund was a negative \$74,436 (an opinion on the legality of a negative fund balance is being sought from the Legislative Services Division). This negative balance does not include unspent appropriations from previous biennia totaling \$572,351. The 2003 legislature over-appropriated money from the capital projects fund in the 2005 biennium. Although \$1,617,005 was anticipated in revenue, an additional \$2,679,777 was appropriated. Based on revenue estimates and the expenditure of all appropriations, the fund would have a negative \$1,707,259 balance at the end of the 2005 biennium (Table 4).

In fiscal 2003, after diversion of \$881,810 to DNRC, \$588,552 of capitol land grant revenue was available to fund projects appropriated by the legislature. However, the legislature anticipated \$827,226. The reduction in available revenue was mainly caused by \$195,345 more being diverted by DNRC to administer trust lands than was anticipated. Statute limits the amount of capitol land grant revenue that can be diverted to 10 percent of the previous fiscal year's revenue. However, the amount diverted in fiscal 2003 was \$305,417, or 27.75% of fiscal 2002 revenues of \$1,100,715. Because part of the \$305,417 was due to prior year activity, the Department of Natural Resources and Conservation feels the 10 percent limit was not exceeded. An opinion on the legality of the magnitude of the diversion is being sought from the Legislative Services Division.

Table 4 Capitol Projects Fund 2005 Biennium	
Beginning Fund Balance	(\$74,436)
Revenues	
Estimated Revenue (HJR 2)	\$1,434,959
Legislation Impacts	<u>182,046</u>
Total Funds Available	\$1,542,569
Disbursements	
Capital projects - HB 5	\$1,572,351
Maintenance - HB 2	1,000,000
Statutory appropriations for debt service	<u>679,477</u>
Total Disbursements	\$3,251,828
Ending Fund Balance	(\$1,709,259)

In fiscal 2003, \$1.2 million, or 78 percent of capitol land grant revenue, was derived from the sale of timber. This revenue source depends on the amount of timber harvested from the capitol land grant trust lands and can be quite variable. Revenue available for DNRC's timber sales program is based on the amount of timber sale revenue from both the capitol land grant and the common school trusts, although the funding mechanism for doing so is not codified. This raises two points: 1) additional variability in revenue occurs when the ratio of timber sale revenue from these two trusts changes<sup>1</sup>. The variability

<sup>1</sup> For example, if actual timber sale revenue from the capitol land grant trust was exactly as estimated, but timber sale revenue from the common school trust was less, more revenue than estimated would be diverted from the capitol land grant trust to fund DNRC's timber sale program leaving less revenue available for the legislature to appropriate for capital projects.

makes it difficult for the legislature to accurately estimate the amount of revenue from this source that will be available to fund capital projects; and 2) other land trusts produce timber sale revenue, but do not contribute funding for the program.

## **EXECUTIVE ACTION/OPTIONS**

To address the fund balance problem, the executive is considering the following cost saving options for the 2005 biennium: 1) not repairing the capitol stairs - \$400,000<sup>2</sup>; 2) not purchasing capitol complex property - \$400,000; and 3) postponing the acquisition of capitol complex land that the 2003 legislature had designated as the last priority - \$600,000. If these appropriations (marked in Table 3) are not used, the \$1.4 million in savings will not be enough to offset the projected ending fund balance of - \$1,707,259. To keep spending within estimated revenues 2005 biennium revenues, the executive must consider a combination of postponing the \$172,351 of remaining capital projects (including \$150,000 for improvements to capitol complex grounds) and reducing expenditures from the \$1,000,000 appropriation for general building maintenance. The statutory appropriations for debt service cannot be postponed or eliminated without defaulting on bond payments. This would negatively impact the state's bond ratings resulting in substantial fiscal impact.

Please note that only the legislature can eliminate House Bill 5 appropriations for projects that are not yet completed. The above executive actions and options only postpone the projects, still leaving a fund balance problem to be addressed by the 2005 legislature.

## **LEGISLATIVE CONSIDERATIONS**

Because answers to legal questions that arose during the research for this report have not yet been received, the committee may want to request a follow-up report once they are received. Depending on the legal responses from the Legislative Services Division, the committee may want to:

1. review the applicability and legality of funding DNRC's administrative costs with capitol land grant trust revenue;
2. implement a statutory funding mechanism for DNRC's timber sales program;
3. encourage DNRC to include all land trusts that produced timber in the funding mechanism for DNRC's timber sales program;
4. recommend that capitol land grant revenue not be appropriated in House Bill 2 for general building maintenance, but rather the necessary funding be collected from rent assessed agencies in the capitol complex to pay these costs;
5. recommend that projects in House Bill 5 that are funded from capitol land grant revenue be prioritized so the executive has clear direction on how to proceed if capitol land grant revenues are short;
6. recommend that the long-range building appropriations subcommittee review all continuing appropriations of capitol land grant revenue to determine if the projects are still a priority over current potential uses of the money and remove the appropriations if they are not a priority; and
7. insert termination dates in House Bill 5 for projects funded from capitol land grant revenue that should be completed within a certain timeframe.

## **LEGAL ISSUES**

A legal opinion has been requested from the Legislative Services Division to answer the following questions. A response had not yet been received at the time this report was written.

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<sup>2</sup> While this report was being prepared, the Governor announced that \$450,000 of the \$50.0 million in federal funds from the Jobs and Growth Tax Relief Reconciliation Act would be used to repair the capitol steps.

1. Are diversions of capitol land grant trust income for administrative expenses constitutional and in accordance with the Enabling Act? Is use of the income for capitol complex building maintenance and improvements to capitol complex land allowable uses?
2. Section 7 of House Bill 5 (2003 session) conditions appropriations of capitol land grant revenue. Do the conditions apply only to the \$600,000 appropriation in subsection 2 or to both the \$400,000 and \$600,000 appropriations in subsections 1 and 2?
3. Is it legal to have a negative fund balance?
4. Section 77-1-109, MCA, appears to limit the “amount of money that is deposited into trust land administration account” from the capitol land grant trust fund to a maximum of “10% of the previous fiscal year revenue deposited into the capitol building land grant trust fund”. Does the word “money” mean only money received from current year activity and not prior year activity, or does it mean all money regardless of when it originated?
5. Section 18-2-107, MCA, states that all revenue from the capitol land grant trust is to be deposited to the capitol projects fund except diversions for the trust land administration fund and the land bank. Currently, the revenue is first deposited in the capitol land grant trust fund and then it is transferred to the capitol projects fund. Does this violate Section 18-2-107, MCA? Sections 77-1-604 through 607, MCA, allow three percent of capitol land grant trust income to be diverted to DNRC for resource development. Are these statutes in conflict with 18-2-107, MCA?